

Service Date: July 6, 1987

DEPARTMENT OF PUBLIC SERVICE REGULATION  
BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MONTANA

\* \* \* \* \*

IN THE MATTER of the Application )	UTILITY DIVISION
of AT&T COMMUNICATION OF THE )	
MOUNTAIN STATES, INC. for Interim )	DOCKET NO. 86.12.67
and Final Authority to Increase )	
its Rates and Charges. )	INTERIM ORDER NO. 5274
_____ )	

FINDINGS OF FACT

On December 12, 1986, AT&T Communications of the Mountain States, Inc. (AT&T) filed an application to increase its revenues by \$3,165,000 annually. This filing was based on eight months of actual data of 1986 annualized to represent twelve months.

On February 27, 1987, AT&T filed a revised application using a twelve month historical test year ended December 31, 1986.

AT&T's revised request for increased annual revenues was \$2,688,000. AT&T requested that interim approval of these rates be considered.

On May 1, 1987, AT&T filed its rebuttal testimony in this docket. AT&T revised its revenue request to \$1,959,000 in this testimony.

On July 1, 1987, the second year of the carrier access charge changes set forth in Docket No. 84.4.15, Order No. 5055g is scheduled to take place. These changes will significantly decrease the amounts that AT&T pays the local operating companies for access to their networks. Order No. 5055g required AT&T to reduce its rates to offset the decreased carrier access charges.

On June 8, 1987, the Commission issued Order No. 5236c in Docket No. 86.11.62. This order required utilities to give effect

to the reduction in federal income taxes pursuant to the Tax Reform Act of 1986. Order 5236c set forth generic methodology to be used to calculate the changes in revenue requirement occasioned by the Tax Reform Act. Interim orders are being issued for individual utilities in that Docket.

The Commission finds that to eliminate customer confusion and conflicting market signals, the reduction necessary on July 1, 1987, the decrease ordered in Docket No. 86.11.62, and the increase granted in this Order should be implemented simultaneously.

The currently authorized overall rate of return for AT&T is 12.08% as follows:

Debt	40%	7.69%	3.08%
Equity	60%	15.00%	9.00%
			-----
Total			12.08%
			=====

This rate of return was established in Order No. 5044d in Docket No. 83.11.80 which was issued in November of 1985. That order was based on rate of return testimony filed by AT&T and Montana Consumer Counsel in early 1985. The present capital market is much different than the one that existed in the first half of 1985. Capital costs have fallen substantially. For example, thirty-year government bonds were between 11.45% and 11.81% in the first three months of 1985. By the end of 1986 these bonds were at 7.37% and are now at 8.75%. (Smith Direct Testimony and 6-30-87 Wall Street Journal)

The Commission has taken these more recent capital markets into account in setting the authorized rate of return for many Montana utilities. For instance in Order No. 5128 in Docket No. 84.7.38 issued on April 26, 1985, the Commission granted

Pacific Power and Light (PP&L) a 14.00% return on equity. Order No. 5169a in Docket No. 85.10.41 issued July 10, 1986, lowered PP&L's authorized return on equity to 12.3%. This rate of return was accepted in a stipulation in Docket No. 86.12.76. AT&T's cost of equity is now much higher than any other authorized return on equity granted by the Commission.

Although the Commission's last order on return on equity for AT&T recognized the fact that AT&T is subject to more risk than the typical local operating telephone company, the Commission is concerned that AT&T's rate of return is now far out of line with current capital markets. For interim purposes the Commission finds that a return on equity of 13.75% is appropriate. The return of 13.75% is still higher than any other return on equity granted by this Commission since 1985. However, this results in a conservative treatment of the return on equity and takes note of the precedent set in Order No. 5044d, Dkt. No. 83.11.80 that AT&T is subject to more risk than other utilities offering primarily monopoly services.

The treatment afforded AT&T's interim return on equity in this order differs from the approach the PSC has used in determining interim returns on equity for the past several years.

The PSC usually accepts the return on equity approved in the utilities most recent final order. The PSC finds however that a long period has elapsed since AT&T's last authorized return was set and during the early 1985 to mid 1987 period the capital costs appear to have fallen substantially. This has been affirmed in our own orders as was explained with PP&L. To ignore these factors would be incorrect.

Although the PSC intends, for most cases, to adhere to the standard of using the most recently determined return on equity

for the affected utility, extenuating circumstances may cause the Commission to deviate from this standard and moderately reflect changing circumstances in interim orders.

The Commission finds that reducing AT&T's return on equity from 15% to 13.75% is a moderate reduction but achieves a reasonable interim balance. The lower end of the range of reasonableness may logically be indicated by the reduction of PP&L's return on equity by 1.7% which would set AT&T's return on equity at 13.30%. The Commission believes a more moderate reduction to 13.75% will achieve a balance without prejudging the issue.

The Commission finds that AT&T's overall rate of return is 11.21% as follows:

Debt	40%	7.4%	2.96%
Equity	60%	13.75%	8.25%
			-----
			11.21%
			=====

AT&T's revenue requirement reflects a rate base addition of \$1,366,000 for cash working capital. The Commission has not approved cash working capital adjustments for telephone companies in the past. The rate base in AT&T's last rate case did not include cash working capital. Therefore, for purposes of interim relief the Commission finds that inclusion of cash working capital is not appropriate. The exclusion of cash working capital decreases AT&T's rate base by \$1,366,000. This adjustment changes the interest synchronization adjustment and so increases net operating income by \$1,000.

AT&T's rebuttal testimony includes a tax rate of 34% and other effects of the 1986 Tax Reform Act. The Commission is

examining the effects of the Tax Reform Act in Docket No. 86.11.62.

The Commission finds that it is procedurally preferable to keep the effects of the Tax Reform Act separate. Therefore, the revenue requirement granted in this interim order does not include the effect of the Tax Reform Act. Removing these effects increases revenue requirement by \$162,000.

The Commission finds that AT&T has an interim revenue deficiency of \$1,688,000 as follows:

Average Rate Base	\$10,759
Rate of Return	11.21%
	-----
Required NOI	1,206
Adjusted NOI - Sch. 1	293
	-----
Difference	913
Net to Gross Multiplier	1.6703
	-----
Revenue Deficiency	1,526
Rev. Req. of TRA	(162)
	-----
Revenue Requirement	1,688
	=====

The latest Commission decision on AT&T rate design was set forth in Order 5055g in Docket No. 84.4.15. That Order and AT&T's last general rate order required AT&T to apply an equal percentage reduction to MTS and WATS. The reduction was limited to the usage elements and targeted to higher mileage bands where intrastate rates were higher than interstate rates. The Commission finds that this same rate design should be used for interim purposes in this Docket. When comparing interstate rates to intrastate rates AT&T should use the interstate rates that will go into effect July 1, 1987.

CONCLUSIONS OF LAW

1. AT&T Communications offers regulated telecommunications services in the state of Montana and is a public utility under Section 69-3-101, MCA. The Montana Public Service Commission has authority to supervise, regulate and control public utilities. Section 69-3-102, MCA. The Commission properly exercises jurisdiction over AT&T Communication's Montana operations pursuant to Title 69, Chapter 3, MCA.

2. The rate levels and spread approved herein are a reasonable means of providing interim relief to AT&T Communications. Interim revenues granted herein are subject to rebate or surcharge should the final order in this Docket determine that a different revenue requirement is appropriate. Section 69-3-304, MCA.

ORDER

THEREFORE, THE MONTANA PUBLIC SERVICE COMMISSION ORDERS THAT:

1. AT&T Communications is granted authority to implement interim rates to generate additional revenues on an annual basis.

3. Rate schedules filed shall comply with all Commission determinations set forth in this Order.

4. The interim relief granted in this order is to be effective for service rendered on and after July 1, 1987.

DONE IN OPEN SESSION at Helena, Montana this 1st day of July, 1987, by a vote of 3 - 2.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

---

CLYDE JARVIS, Chairman

---

DANNY OBERG, Commissioner

Voting to Dissent

---

JOHN B. DRISCOLL, Commissioner

---

HOWARD L. ELLIS, Commissioner  
Voting to Dissent

---

Thomas Monahan, Commissioner

ATTEST:

Ann Purcell  
Commission Secretary

(SEAL)

NOTE: Any interested party may request that the Commission reconsider this decision. A motion to reconsider must be filed within ten (10) days. See 38.2.4806, ARM.